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# ***Open skies, open clubs and open regionalism***

*some new issues for Asia Pacific Economic Cooperation*

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## **Introduction**

In late 1994, APEC leaders committed themselves to the objective of free and open trade and investment by 2010 and 2020, for developed and developing member economies, respectively. The nature of free and open trade and investment and the means for approaching it are set out in the Osaka Action Agenda. That document makes it clear that the region aims to go well beyond eliminating tariffs and other border barriers to trade in goods. Trade liberalisation is to be accompanied by a wide-ranging set of co-operative arrangements to facilitate international trade and investment; reducing the costs and risks imposed by limits on information and communications as well as by widely different approaches to domestic administrative procedures and commercial regulation.<sup>2</sup> The broad objective could be described as seeking to achieve economic integration of the Asia Pacific region, comparable in scope and depth to that achieved within the European Union (EU).

At the same time, the Osaka Action Agenda defines an Asia Pacific model of regional economic co-operation which differs radically from the approach adopted in Europe. Free and open trade and investment is to be approached through a process of voluntary co-operation. Reforms to promote free and open trade and investment are to be implemented by means of unilateral, but concerted, decision-making by Asia Pacific governments. Each APEC government is free to set its own schedule for trade liberalisation to eliminate border barriers to trade and investment by the agreed 2010/2020 deadlines. Co-operation to facilitate trade or investment, for example by reducing difference in administrative procedures or by improving communications, generally requires collective action by several governments. Consistently with the voluntary nature of APEC, the Osaka Action Agenda encourages those member economies which are ready to implement co-operative arrangements to facilitate trade or investment to do so ahead of others, who are free to join once they perceive the benefits of joining those arrangements. Such flexibility is in sharp contrast with the general requirement for all EU members to adopt economic policies which are agreed by an appropriate (often weighted) majority of members.

Another significant contrast to the EU model of economic co-operation is that APEC is based on the concept of open regionalism. This means that Asia Pacific governments co-

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- <sup>2</sup> The Osaka Action Agenda sets out the general directions of reforms to be implemented by APEC governments to dismantle impediments to all international economic transactions, including initiatives on:
  - tariffs;
  - non-tariff measures, such as quantitative export or import restrictions and export subsidies;
  - trade in services, with detailed programs of reform of telecommunications, transport, energy and tourism;
  - international investment ;
  - standards and conformance;
  - customs procedures;
  - intellectual property rights;
  - competition policy;
  - government procurement;
  - deregulation;
  - rules of origin;
  - dispute mediation;
  - mobility of business people;
  - implementation of the Uruguay Round;
  - information gathering and analysis as a basis for future steps.

operate to reduce impediments closer economic integration among themselves, without seeking to divert economic activities from rest of the world. Up to now, open regionalism has been used to distinguish between the liberalisation of border barriers to trade on a most-favoured-nation (MFN) basis, as against the preferential, or discriminatory, approach adopted by trading blocs such as the EU. As APEC governments develop concrete proposals to facilitate trade and investment, for example by harmonising product standards or administrative procedures, the concept of open regionalism will need to be spelt out in more detail to ensure that co-operative arrangements among some participants take adequate account of the interests of other APEC economies.

The 21 diverse members of APEC already account for over half of global production.<sup>3</sup> The share of their total trade which takes place among APEC participants is comparable the share of the total trade of EU economies which takes place with other parts of the EU. However, the links between APEC economies and the rest of the world are also very important; APEC's progress towards free and open trade and investment will take place in parallel to other initiatives to promote the economic integration of some Asia Pacific economies with Europe, or other parts of the world.

Two summit meetings of East Asian and European heads of governments have already taken place as part of the Asia-Europe Meeting (ASEM) process, which is likely to lead to practical initiatives to facilitate trade and investment between Europe and East Asia. A number of sub-regional initiatives in the Western Hemisphere, which involve several APEC participants are expected to lead towards a Free Trade Area of the Americas. Links between the EU and North America are also intensifying. The New Transatlantic Agenda of 1995 has already led to a 1997 Mutual Recognition Agreement and has been followed up, in March 1998, with an ambitious proposal for a New Transatlantic Marketplace (NTM).<sup>4</sup> If followed up, this proposal would result in deep integration of the EU with the United States which would be comparable in scope and depth to the free and open trade and investment ambition of APEC governments.

All of these initiatives for regional economic co-operation can promote progress towards global free and open trade and investment. However, a proliferation of new arrangements among overlapping groups of economies could also undercut the relevance of the WTO and place serious strain on the cohesion of APEC. For example, a co-operative arrangement between North American and European economies, possibly for mutual recognition of certain standards, can provide a positive example for others. On the other hand, such new arrangements could also sow the seeds of confusion or division if they failed to take adequate account of the interests of those APEC economies outside these arrangements. These problems can be overcome if new co-operative arrangements involving some (or all) APEC economies are 'open clubs' which:<sup>5</sup>

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<sup>3</sup> APEC participants in 1998 are Australia, Brunei, Canada, Chile, China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Chinese Taipei (Taiwan), Thailand, United States of America and Vietnam

<sup>4</sup> The proposal for a New Transatlantic Marketplace is reported in a communication of Sir Leon Brittan, Mr Bangemann and Mr Monti to the European Commission (European Union, 1997).

<sup>5</sup> As Snape (1996) points out, there is a precedent in the GATS for a club approach to liberalisation. This precedent applies to professional services. Article VII of the GATS provides that members can recognise the qualifications of suppliers from other countries and that this might be the result of negotiation or of autonomous action. But once recognised in this way, members are obliged to provide opportunity for other interested members to negotiate accession or to demonstrate that they meet the criteria. Members are also to report their

- do not seek to disadvantage outsiders;
- have transparent ‘rules’, including transparent criteria for admitting new members; and
- actively promote wider membership.

As explained in this paper, it is not easy to ensure that new arrangements for closer economic co-operation among groups of economies are open clubs. The great majority of existing arrangements to promote closer integration among some economies discriminate against outsiders. Even those which do not contain explicitly preferential features will, by reducing the costs or risks of trade or investment among one group, tend to divert economic activity away from others. Such diversion can be reduced if co-operative arrangements are transparent, but in practice, the only way for outsiders to prevent diversion is to join arrangements pioneered by others. This points to the desirability of agreed and operational criteria which generalise the idea of open regionalism.

By examining the issues involved in creating a more open and competitive environment for international air transport, the paper illustrates how co-operative arrangements among some economies can affect others and how they can be designed to be open clubs which take account of the interests of others. The paper proposes a concise set of principles for:

- transparency;
- non-discrimination;
- accession; and
- review.<sup>6</sup>

These guidelines can be applied, not just to new arrangements for international air transport, but also to all co-operative arrangements to facilitate trade or investment which involve APEC economies.

APEC is an attractive institution for the application of these principles to the development of new arrangements for air transport. This is the case for a number of reasons.

- ➔ First, the guiding principles are APEC are consistent with, and are found new and more specific application in, those suggested here for air transport.
- ➔ Second, APEC members include many rapidly growing air transport markets in which a number of pressures on the current regulatory system are already evident. These include the pressure on the bilateral system now being applied by the US negotiating position (which is explained below, and to which East Asian APEC members are responding individually rather than as a group). Furthermore, airlines in this region are going to be looking for new market access arrangements if they are going to be able to use the capacity which they have already committed to purchase from the aircraft manufacturers. New airports in the region, that in Hong Kong, for example, will also be seeking the growth in traffic that new regulatory arrangements are expected to facilitate.

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negotiations or decision to the WTO Council for Trade in Services. Members are urged to use already agreed international standards or to work towards such standards.

<sup>6</sup> A set of generally applicable criteria for open clubs to facilitate trade or investment among groups of economies was first proposed by Drysdale, Elek and Soesastro (1997).

- Third, APEC's informal nature has some advantage in the implementation of these principles, as we explain below. In particular, APEC can provide an opportunity to encourage adherence to such open club criteria through peer review.
- Fourth, APEC can provide a forum in which sub-regional arrangements can be monitored. As APEC gathers momentum, Asia Pacific governments will become increasingly aware of the need to ensure that co-operative arrangements among some participants are indeed capable of subsequent region-wide application. They will also need to ensure that new arrangements do not create new sources of discrimination, thereby fragmenting, rather than integrating regional markets. That is likely to lead to the search for procedures which generalise the fundamental GATT/WTO principles of transparency, non-discrimination and national treatment and apply them to new issues in international economic co-operation.

### ***The future of open regionalism***

When the GATT was established in the 1940's, international commerce was dominated by trade in commodities and finished manufactures. Its articles were designed to create a predictable, rules-based framework for trade in goods.<sup>7</sup> Until the recent Uruguay Round of trade negotiations, trade policy was dominated by discussions of how to reduce tariffs and non-tariff barriers to trade in goods.

Article I requires that parties to the GATT treat all others on an MFN basis, which means that the same barriers apply to all trading partners except under well-defined circumstances spelt out in other articles. Under some circumstances, Article XXIV does allow groups of economies to eliminate barriers to trade in goods without reducing them against non-participants, thus creating a preferential, or discriminatory, trading arrangement.<sup>8</sup>

From the outset, APEC participants have been committed to co-operation which is fully consistent with all relevant GATT/WTO articles. Since APEC governments have rejected the option of setting up a formal trading arrangement under Article XXIV, any liberalisation of barriers to trade in goods with respect to all APEC trading partners also has to be extended to other members of the WTO on an MFN basis. Accordingly, for trade in goods, open regionalism can be simply defined as the reduction of border barriers among participants on a MFN basis, consistently with Article I of the GATT.<sup>9</sup>

The scope of international economic transactions has widened considerably during recent decades. Trade in services, international investment and the international movement of

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<sup>7</sup> Trade in agriculture was exempted from normal GATT principles in the 1950's, while a number of 'temporary' arrangements leading up to the Multi Fibre Arrangement subsequently removed most trade in textiles and clothing from those disciplines. The Uruguay Round outcome provides for bringing trade in these products under normal GATT/WTO principles.

<sup>8</sup> Article XXIV of the GATT allows groups of economies to enter into a preferential arrangements for trade in goods, provided that all border barriers to trade in goods are eliminated on substantially all goods within the group according to a formally agreed timetable (normally no longer than ten years) and no new barriers are raised against other economies.

<sup>9</sup> It should be noted that the majority of APEC participants also belong to formal sub-regional preferential trading arrangements. That means that unilateral reductions of tariffs and non-tariff barriers to trade in goods could be accompanied by even more rapid liberalisation within these arrangements, raising the prospect of some new discrimination within APEC. So long as APEC governments meet their commitment to dismantle all border barriers to trade by 2010/2020 consistently with Article I, such discrimination will be temporary.

people and information have become increasingly important complements to trade in goods. It has also become evident that border barriers are not the only impediments to international transactions. The most significant costs and risks faced by those engaged in international commerce are due to inadequate information, bottlenecks in transport and telecommunications as well as by the divergent approaches to domestic administrative procedures and commercial regulation, including different approaches to competition policy.

Beginning with the Uruguay Round, the GATT/WTO has sought to address some of the many new issues of trade policy raised by these new realities. In addition to an agreement to bring all trade in goods under normal GATT/WTO disciplines, there has been some progress towards extending the fundamental principles and disciplines to a wider range of international economic transactions. Nevertheless, the GATT/WTO principles of transparency, non-discrimination and national treatment have yet to be extended systematically to cover other international economic transactions, such as trade in services or international investment. Similarly, the concept of open regionalism also needs to be extended to guide economic co-operation in new areas, reflecting the more complex nature of transactions beyond trade in goods and the nature of co-operation required to reduce impediments to such transactions.

For example, the impediments to direct foreign investment are by no means restricted to exchange controls which impose border barriers on capital movements. The most significant issues are the domestic regulations, imposed by most governments, which apply differently to firms depending on their place of registration, of the nationality of their owners. GATT/WTO disciplines do require 'national treatment' of all products once they have entered an economy, irrespective of where they were produced. However, there is no corresponding general provision for the national treatment of producers, irrespective of ownership. It follows that the core principle of any international set of understandings and disciplines for direct foreign investment will need to be a general provision for national treatment of all firms, irrespective of ownership, except in well-defined specific circumstances<sup>10</sup>.

Such 'domestic' issues also loom large for international trade in services. For example, promoting free and open trade in international air transport requires far more than efforts to ease restrictions on the right to land and load/discharge passengers or cargo in another country. To exercise these rights in practice, a foreign airline also needs a policy environment which assures comparable treatment of all airlines under the wide range of domestic procedures and regulations which affect their day-to-day operations (for example, regulations on their ability to own or rent terminal gates or procedures for the safety inspection of their food catering services).

Similar issues need to be addressed to promote a more competitive environment for international trade in all services. The GATS requires all parties to apply the principles of transparency and MFN treatment to all services (unless specifically excluded in the schedules of commitments). On the other hand, the principles of national treatment and market access only apply to particular services if they are specifically listed by various

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<sup>10</sup> Some of these issues are under consideration in the proposed Multilateral Agreement on Investment (MAI). However, that agreement is being negotiated among members of the Organisation for Economic Cooperation and Development (OECD); moreover, even these economies may fail to endorse such an agreement.

members of the GATS. In addition, some important sectors, such as international air transport, have been explicitly excluded from the GATS.<sup>11</sup>

Reacting to the importance of new issues, most experiments in regional economic co-operation are addressing the reduction of impediments to trade and investment beyond dismantling border barriers. The EU's Single Market Program involved a large number of collective decisions to promote the convergence, mutual recognition or harmonisation of product and process standards, administrative procedures and commercial regulations. As noted at the outset, APEC governments have committed themselves to dealing with these issues as part of their drive towards free and open trade and investment. More recently, the NTM proposal to reduce barriers between the EU and the United States is advocating the widespread removal of technical impediments through increased mutual product recognition and harmonisation in addition to co-operation to reduced border barriers to trade and investment.

Co-operation to promote convergence, mutual recognition or harmonisation requires groups of governments to enter into co-operative arrangements under which participants agree to adopt agreed norms for the conduct of certain policies which influence international economic transactions. Some of these arrangements, for example agreements on electronic communication and harmonised processing of customs data, involve time-consuming design and deployment of compatible software and administrative procedures. It is inevitable that some groups of governments will move ahead of others.

GATT/WTO disciplines seek to avoid the use of technical arrangements being used with an intent to discriminate against, or among, trading partners, but that is not sufficient to avoid the potential fragmentation of markets. Nor is it feasible to apply a simple MFN rule - for example arrangements for mutual recognition of product and process standards can only extend to economies whose governments decide to, and are able to, adopt the policy norms of such arrangements. In many cases, the only practical means of avoiding unintended diversion of economic activity from those not involved in co-operative arrangements to facilitate trade or investment is to enable and to encourage them to join.

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<sup>11</sup> The Annex on Air Transport Services reads:

1. This Annex applies to measures affecting trade in air transport services, whether scheduled or non-scheduled, and ancillary services. It is confirmed that any specific commitment or obligation assumed under this Agreement shall not reduce or affect a Member's obligations under bilateral or multilateral agreements that are in effect on the date of entry into force of the WTO Agreement.
2. The Agreement, including its dispute settlement procedures, shall not apply to measures affecting:
  - (a) traffic rights, however granted;
  - (b) or services directly related to the exercise of traffic rights,except as provided in paragraph 3 of this Annex
3. The Agreement shall apply to measures affecting:
  - (a) aircraft repair and maintenance services;
  - (b) the selling and marketing of air transport services;
  - (c) computer reservation system (CRS) services.
4. The dispute settlement procedures of the Agreement may be invoked only where obligations or specific commitments have been assumed by the concerned Members and where dispute settlement procedures in bilateral and other multilateral agreements or arrangements have been exhausted.
5. The Council for Trade in Services shall review periodically, and at least every five years, developments in the air transport sector and the operation of this Annex with a view to considering the possible further application of the Agreement in this sector.

In effect, as illustrated below, the principle of MFN needs to be translated to principles which require new co-operative arrangements among groups of governments to be open clubs.

### ***International air transport***

The pattern of trade in most products is largely determined by the comparative advantage of producers in various locations, though qualified by the costs and risks imposed on transactions by natural or policy-based impediments. International air transport is quite exceptional in that the regulatory framework not only seeks to prevent comparative advantage from influencing the pattern of trade, but also often restricts the existence of absolute advantage from affecting the market shares of service providers.

The system of bilateral aviation agreements, which severely limit market forces from influencing the pattern of trade in international air transport has proved to be remarkably resilient - even surviving the Uruguay Round of trade negotiations which saw the rules of the world trading system applied to many service sectors. It has been acknowledged for some time that it is unrealistic and counter-productive to expect to move in a single bold step from the existing system of bilateral agreements on international aviation to free and open trade in aviation operating under general GATT/WTO principles and disciplines.

The prospects of a WTO-consensus to end the exemption of international air transport (and possibly maritime transport) from normal GATS disciplines appears some time away, and in that case, the Annex on Air Transport would be retained. Within this structure, we argue here, there are prospects for evolutionary change. Like any other systematic attempt to counter market forces, the current regulatory system is continually besieged by new realities and faces a growing number of challenges. Several of these, such as the increasing density of routes, the privatisation of carriers, new corporate alliances among carriers from different regions or countries and regional economic co-operation initiatives have been identified.<sup>12</sup> But there is a new threat to the regulatory structure emerging, interestingly, from within bilateralism itself

### ***Bilateral "Open Skies" agreements***

The United States has recently wrought some major changes from some of its bilateral agreements through the application of so-called 'Open Skies Agreements'. The United States has negotiated such agreements in Europe and has now started signing them in the Asia Pacific region, beginning with Singapore, Malaysia, Brunei, Taiwan and New Zealand. Negotiations are continuing with Korea. Negotiations with Japan, which were concluded in early 1998, have given the United States unlimited pick-up rights for services beyond Japan, as well as access to wholesaling operations in Japan. The new agreement liberalises code sharing and joint route operations. It also removes some restrictions on All Nippon Airways, but other carriers, including those from the United States which were not 'incumbents' remain restricted.<sup>13</sup>

The Open Skies strategy grows out of the bilateral system. It retains the key feature of that system which is discrimination against third parties. Countries that do not enter into such agreements with the United States risk a loss of traffic because of the diversion of

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<sup>12</sup> See, for example, Findlay (1997), Findlay, Chia and Singh (1997) and Findlay and Warren (1998).

<sup>13</sup> For this reason, the agreement with Japan does not meet the Open Skies standard set by the United States. A further important constraint on airlines taking advantage of new flexibility is limits on airport capacity. There are currently no slots at Narita and entrants will have to fly to Osaka or wait for new capacity to become available after 2001 in Narita or Nagoya.



travellers to routes which are more competitive, where frequencies are higher and where service is better. The process of reforming international air transport by this bilateral route therefore creates some real advantages for those who move first, and in particular for the United States carriers. In this way, the development of Open Skies agreements is expected to bring pressure on those who have not signed to join up.

However, these 'hub-and-spokes' agreements do not necessarily achieve an adequate standard of openness. For example, Open Skies agreements do not cover domestic routes. Therefore the United States carriers have the advantage of being able to draw on their extensive domestic networks to which Asian carriers do not have direct access. Moreover, the United States continues to insist that those on United States government business use United States airlines.

At the same time, a sequence of Open Skies agreement agreements, by themselves, give United States carriers much more liberal access to Asia Pacific routes. To see why, suppose the United States signs up with both Singapore and another ASEAN economy. Then the United States airlines and those of the signatory country have free access - in terms of capacity and also points served - on all the routes between the two countries. Even more significant is that these Open Skies agreements also generally provide each party with automatic beyond rights. That is, the United States airlines have the right to pick up traffic in a signatory country and carry them to other destinations, subject to the agreement of those destinations.

In effect, a set of such agreements gives United States airlines unrestricted rights to operate anywhere within the 'region' covered by its bilateral agreements. However, by themselves, such 'hub-and-spokes' agreements do not create open regional skies for any airline based in the region, but tend to confer much greater benefits to the United States hub. Returning to the ASEAN example, if the United States has signed Open Skies agreements with both Singapore and another ASEAN country, then United States carriers will have unrestricted access to routes between Singapore and its ASEAN partner. However, airlines of the two ASEAN economies only have free access on their direct routes to the United States, but not necessarily between themselves.

Several conditions would need to be met ASEAN carriers to gain the right to the same access as US carriers already have from the 'hub-and-spokes' agreements. Firstly, the ASEAN governments would need to sign Open Skies agreements among themselves. Secondly, they would need to ensure that their own agreements with the US do not contain undue restrictions on their ability to exercise their beyond rights to carry passengers or cargo to the US.<sup>14</sup>

It may be seen that East Asian carriers run the risk of being caught out by these Open Skies agreements, unless they act quickly. To compete, they have to duplicate the access available to the United States on routes between them. They could also think about how to duplicate within the region the sort of feeder system that the United States carriers have within their own economy. Singapore and New Zealand, as well as other ASEAN economies, have already signed such an agreement with the United States. It might be possible to extend this trend to include all the ASEAN economies and Australia; that option could be an agenda item for the ongoing discussions between those economies under the AFTA-CER framework.

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<sup>14</sup> Aviation agreements can place limits on the exercise of beyond rights, for example by insisting that a minimum share of passengers are from the point of origin, rather than from intermediate ports.

Some care will need to be taken to ensure that regional open skies can, indeed, evolve from overlapping bilateral, or even sub-regional, agreements. For example, the terms of all the underlying agreements would need to avoid any biased restraints on the exercise of beyond rights. That, in turn, requires that the terms of all the agreements be transparent to third parties and permit them to link, on equivalent terms, to an existing set of agreements.

### ***From bilateral to regional agreements***

It may be seen that, a series of bilateral, 'hub-and-spokes' Open Skies agreement with the United States (or any other hub) does not lead smoothly towards a progressively more open, competitive and non-discriminatory international system for trade in international air transport. The 'spokes' need to co-operate among themselves in similar terms as with the hub and have, in fact, already begun to do so. In addition to developments already discussed, a number of incipient regional air transport arrangements are merging. The ICAO has identified 50 different groupings of states that are, or could become, involved in the regulation of aviation. These include:

- in April of 1997, a single aviation market was created in the European Union and airlines from member economies will be able to operate anywhere within the bloc;
- Argentina, Bolivia, Brazil, Chile and Paraguay recently signed a regional agreement (Mercosur bloc) and this has been mooted as a step towards a pan-American 'civil aviation network governed by a single multilateral regional air transport agreement' (Pereira 1996);
- there is a single aviation market between Australia and New Zealand (Findlay and Kissling, 1997);
- in 1994, Indonesia, Malaysia and Thailand signed a joint Memorandum of Understanding under which regional flights would be encouraged within the 'Northern Growth Triangle'. Each of the signatories was free to designate two airlines that would be permitted to operate whatever capacity they wish between secondary airports on a scheduled or charter basis, carrying passengers and/or cargo. In situations where this arrangement was at variance with air services agreements, the latter were to take precedence. Since then, the Philippines and Brunei have joined and the bloc is known as BIMP-EAGA (Brunei, Indonesia, Malaysia, Philippines - East Asia Growth Area) and it covers a market with a potential of 250 million air travellers (Ballantyne 1996);
- discussions between Thailand, Myanmar, Vietnam, Cambodia, Laos and the Yunnan Province of China have mooted another aviation bloc.
- although Japan has a more protectionist approach to aviation policy, it attempted in 1995 to create an Asian aviation forum to achieve regional cooperation on aviation policies (Ballantyne 1995).

The proliferation of regional arrangements raises the question whether these, in turn, are likely to serve as a sensible route towards the evolution of a rational global air transport system. For example, when the Mercosur bloc was formed, there was immediate interest in the development of new North-South routes. Within the group of member countries, a liberal approach appeared conducive to the establishment of new services, but an added attraction is that these would operate free of direct competition from the powerful carriers from the United States.

There is a distinct possibility that the formation of blocs could result in greater competition within them, but barriers could rise for airlines from outside the region, in the absence of WTO-type limits on discrimination (Ballantyne 1996). Protectionist blocs with large internal markets could use their power to the disadvantage of smaller parties. Spurred on by competition from within the bloc, efficient airlines drawing upon a large market could become dominant carriers on inter-bloc routes (Nuutinen 1992).

ICAO has addressed this matter, but there is insufficient experience with blocs to make any firm predictions. Indeed, the Director General of the International Air Transport Association was reported to have urged African nations to pursue a strategy of liberalising competition within a bloc to promote efficiency and development, but to use the bloc as a countervailing force to deal with powerful external interests (Vandyk 1995). However, if blocs were to adopt an open approach to membership at the same time as promoting liberal competition within the group, they could become the driving force of multilateralism.

### ***Open regionalism in Asia Pacific air transport***

Assessing options for an Asia Pacific regional response to the emergence of hub-and-spokes' arrangements with the United States, Findlay, Chia and Singh (1997) have suggested that the economies of the region, working within existing trade agreements such as AFTA, or under APEC auspices, develop an open aviation club. Such an Asia Pacific approach to international air transport in the region would be to sign up a number of countries simultaneously, then to encourage other new members to join the group later if they wish but on the same terms as the foundation members, and to put no cap on membership. Members of the club would exchange open skies agreements with each other, but with the additional key feature that other new members would be welcome on the same terms.

Ideally, the policy norms of such an open aviation club would be even less restrictive than those imposed by the United States in its recent 'hub-and-spokes' agreements. Smaller Asia Pacific economies would have a strong incentive to join. Membership would not only provide a wider aviation market, but could also provide them with the collective capacity to obtain better access to the United States market. The United States would be welcome to join the club if agreed to adopt these more liberal norms. If it chose not to revise its existing agreements, its access to the new regional aviation market created by the open club would be limited to those already negotiated in its bilateral agreements with various members of such a club.

Such an open arrangement in the Asia Pacific would be preferable to the currently emerging 'hub-and-spokes' pattern, making it possible for a group to pioneer new, less restrictive rules of the international air transport game in one part of the region. Others, including the United States, would then be encouraged to adopt the same pro-competitive policy norms.<sup>15</sup> Such an approach could also serve as a model for regional

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<sup>15</sup> In addition to liberal rights of access to regional air transport markets, the Asia Pacific could also pioneer means of dealing with disputes associated with competition policy issues. Airlines will continue to remain concerned about government initiatives that affect competitive processes, such as charging regimes, as well as subsidies for the provision of particular services, but also business practices. While not creating a new multinational competition policy institution, the terms of regional arrangements could include a mechanism for dealing with disputes over these sorts of issues. For example, such a dispute resolution mechanism might include an agreement to nominate a person who is acceptable to all as Chair of a regional industry-specific competition policy dispute panel. Two parties to a dispute could then each nominate another panel member to join the Chair to hear the dispute. Regulatory bodies in the

air transport arrangements beyond the Asia Pacific - these could subsequently coalesce towards a non-discriminatory, competitive global air transport regime, rather than lead towards countervailing, closed regional arrangements.

### ***Open clubs and open skies***

Recent developments suggest that reform of the international air transport is likely to proceed by the liberalisation of existing bilateral arrangements towards 'open skies' agreements, followed by sub-regional and regional arrangements, partly in response to bilateral initiatives.

The issues raised by the above examples also suggest that it may be possible to draw up criteria which should be met by new air transport arrangements between pairs, or among groups, of governments. These criteria would help ensure that such arrangements can be useful stepping stones towards an open, non-discriminatory and competitive global regime.

Relevant criteria for new agreements include the following:

- they certainly need to be transparent;
- they should not aggravate the already extremely discriminatory system of international air transport; therefore, new arrangements should not create new sources of discrimination among carriers;
- to be open clubs, they will need to contain, from the outset, automatic rights of accession of those who are willing to co-operate with existing members on equivalent terms; moreover, accession by additional members should be actively encouraged.
- finally, for such criteria to be operational, non-participants will need to have the right to ask for a review of provisions in agreements which do not appear to be consistent with the three preceding criteria.<sup>16</sup>

As discussed above, such guidelines for new arrangements in international air transport could be pioneered by some APEC governments. Any such arrangement would, by definition, be capable of being expanded to include all APEC governments. Indeed, consistently with the spirit of open regionalism, all governments who are prepared to abide the provisions of such agreements should be encouraged to join them, even if they are not APEC participants. More generally, such criteria could be adopted for all new arrangements for international air transport, not only within the Asia Pacific, but also for agreements linking APEC economies to the rest of the world. That could facilitate the evolution of new multilateral criteria along these lines, bringing international air transport within principles compatible with the WTO and GATS.

### ***Open clubs and open regionalism***

The criteria proposed for open clubs for international air transport echo those discussed by Elek and Soesastro (1997) and Drysdale, Elek and Soesastro (1998) who illustrate that an open club approach could be applied more generally. Guidelines for transparency, avoiding new sources of discrimination, third party rights of accession and

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relevant member economies, where they exist, could also participate in the hearing of the dispute, in particular, to provide advice on whether on any solutions proposed contravene local legislation or policy.

<sup>16</sup> These criteria are set out as proposed principles later in the paper.

review, can help assure that co-operative arrangements dealing with matters ranging from direct foreign investment, harmonising administrative procedures, mutual recognition of product or process standards and technical co-operation are designed as open clubs. It follows that such criteria could serve to ensure that new co-operative arrangements to facilitate trade or investment among any group of economies takes adequate account of the interests of others. Accordingly, they are likely to prove useful in guiding the evolution of APEC.

The remarkable diversity of Asia Pacific economies means that it would be counter-productive to insist that all APEC participants be involved in every specific initiative for co-operation. Accordingly, the Osaka Action Agenda encourages those APEC participants who are ready to implement co-operative arrangements, whether in international air transport or in other fields, to do so ahead of others. This provision can promote rapid progress as long as the initiatives taken by some are positive examples which are designed to maintain the cohesion of APEC and to provide practical means, as well as incentives, to widen the coverage to include all of the region.

At the same time, such a '21-x' provision carries some risks.<sup>17</sup> As already remarked, initiatives by some APEC economies to facilitate trade or investment could sow the seeds of division and confusion if these arrangements neglected, or damaged, the interests of others - instead of promoting further market-driven integration of Asia Pacific economies, they could lead to an inefficient and needless fragmentation of markets.<sup>18</sup>

WTO principles and disciplines contained in the GATT, the GATS and other agreements or protocols already cover important aspects of trade in goods and services. It is likely that corresponding principles will come to be applied over time to foreign direct investment as well as co-operative arrangements to reduce the costs and risks of international economic transactions, for example by the convergence, mutual recognition or harmonisation of regulations or administrative procedures among groups of governments. It will be some time before detailed international agreements can be put in place to cover such matters. Moreover, the range of international economic transactions continues to expand and more and more economic and commercial policies, previously considered to be purely domestic matters are acknowledged to influence the volume and direction of international economic transactions.

Therefore, it would seem useful to adopt some broad guidelines for all co-operative arrangements to facilitate trade and investment. These should not seek either to compete with, or to dilute existing GATT/WTO provisions where they apply, but to establish some criteria to encourage new co-operative arrangements, dealing with new issues. If such arrangements are designed to be open clubs, then they would be able to expand as well as to coalesce with other clubs, thus evolving naturally towards multilateral disciplines and understandings on new issues in international economics.

APEC is well placed to pioneer such new principles. If such guidelines were adopted, they could help to manage the 'variable geometry' which is certain to emerge. The non-

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<sup>17</sup> This provision, stated in the Osaka Action Agenda was originally termed the '18-x' provision, since APEC had 18 participants at that time.

<sup>18</sup> The 21-x rule also means that those not involved originally in an initiative are not able to veto its introduction, thereby avoiding a problem of having such arrangements meet the interests of the lowest common denominator. At the same time, it is important that members not participating have an opportunity to comment on the arrangements being proposed. There might also be some consideration for transitional arrangements for members who are not original signatories to a club. Furthermore, as the principles suggest, a club of this type would not be restricted to APEC members.

formal nature of APEC can also provide an opportunity to encourage adherence to such open club criteria through peer review. That, in turn, could help such broad principles to evolve naturally in different directions to cover the specific issues which are likely to arise when considering any particular set of international transactions or co-operative arrangements.

The following paragraphs set out to specify, in more detail, guiding principles which can avoid these potential problems. Such principles can help ensure that co-operative arrangements involving APEC economies, not only in air transport but more generally, are consistent with the spirit of open regionalism.

### ***WTO-consistency***

The primary aim of the APEC process is to promote regional co-operation which can help deepen, broaden and widen the capacity of the WTO-based multilateral system to reduce impediments to all international economic transactions and to reduce discrimination among products and producers. As stated in the Seoul APEC Declaration Asia Pacific governments are to

*“ .. reduce barriers to trade in goods and services among participants in a manner consistent with GATT principles, where applicable, and without detriment to other economies.”*

It follows that all new co-operative arrangements involving APEC economies should be fully consistent with any WTO provisions, expressed in the GATT, GATS or any other WTO-based agreement. At the same time, WTO provisions do not apply to certain types of international economic transactions or to co-operative arrangements among groups of economies. Where they do apply, they may not, in all cases, prove sufficient to ensure that new co-operative arrangements are designed to be open clubs consistent with the concept of open regionalism and the intent of the Seoul APEC Declaration.

Accordingly, without prejudice to any existing WTO-based disciplines or provisions, all co-operative arrangements involving APEC economies should satisfy the following criteria for transparency, non-discrimination, accession and review.

### ***Transparency***

Perfect transparency may be an ideal, but it is possible to agree on criteria which co-operative arrangements involving APEC economies should meet. For example, guiding principles for transparency could require that the policies and procedures adopted for these arrangements be set out explicitly, typically in their legislation or regulations. These should be freely accessible to all governments and producers who wish to do so - in practice that can be achieved by preparing (where applicable) an authoritative translation to English, which is the working language of APEC. The policy norms of ‘open clubs’ should be available to all those interested, free of charge, through one of more recognised channels. In 1998, that would probably be on a World Wide Web site accessible, among many other ways, through the APEC Secretariat’s ‘home page’.

A second important aspect of transparency is prior notice of new arrangements (or significant amendments to existing arrangements). That can enhance the prospects for more economies to join these new arrangements at the outset. Prior notice can also allow governments of other economies to comment on the terms of the proposed arrangements. Such comments could improve the effectiveness of these arrangements and help to make them as consistent as possible with the APEC’s guiding principles for trade and investment liberalisation and facilitation.

### ***Non-discrimination***

For trade in goods and services, the WTO has adopted the combination of ‘standstill’ and ‘roll-back’ to promote a gradual trend towards non-discriminatory free trade. The liberalisation of border barriers to trade, by individual governments or groups of governments, is expected to reduce some barriers without raising existing ones or creating new obstacles. Such a strategy can be generalised to promote co-operative arrangements to reduce all impediments to all international economic transactions.

APEC’s agreed principles of ‘standstill’ and the commitment to ‘endeavour to apply the principle of non-discrimination’ can be given effect by guidelines which stipulate that new co-operative arrangements involving APEC economies should not lead to new discrimination. It will also be necessary to generalise the concept of national treatment to deal with the issues involved in reducing impediments to trade in services as well as to international factor movements. Accordingly, new arrangements should not contain any provisions which create additional or new forms of discrimination among products or producers, either on the basis of the location of various stages of production or the place of registration or ownership of producers.

### ***Accession***

As shown by the preceding examples, co-operative arrangements to facilitate trade or investment will tend to divert economic activities to the economies involved. Moreover, those who benefit from the diversion of trade or investment, intended or unintended, will tend to resist accession by additional economies. Therefore, if co-operative arrangements involving APEC economies are to be genuinely open to accession, their design will need to anticipate and minimise such resistance.

To a large extent, that can be achieved if the arrangements are highly transparent and do not create new discrimination among products or producers. In addition, the arrangements should specify, at the outset, that the only condition for accession by additional economies will be their demonstrated ability to follow policies consistent with the arrangements. Since many arrangements to facilitate trade or investment are technically complex, they will be ‘open clubs’ only if existing members are willing to share the requisite information, experience, expertise and technology. The 1996 *Ministerial Declaration on an Asia Pacific Economic Cooperation Framework for Strengthening Economic Cooperation and Development* commits all APEC participants to such pooling of resources.

### ***Review***

As shown by the earlier examples, it is not easy to ensure that co-operative arrangements among some economies are genuinely open clubs. While they may be designed, in good faith, to meet APEC’s agreed guiding principles for trade and investment liberalisation and facilitation, their implementation could cause unexpected problems for other economies. Therefore, those involved in these arrangements should be willing, once again in good faith, to respond to constructive suggestions from other economies on how to improve the consistency of these co-operative arrangements with agreed guiding principles.

### ***Proposed principles***

Based on these considerations, the principles proposed below build on those of the Osaka Action Agenda; generalising the concept of open regionalism as well as the

fundamental principles of transparency, non-discrimination and national treatment which lie at the heart of the GATT/WTO system. They can be expressed as follows:

*APEC economies that are ready to initiate and implement co-operative arrangements to reduce impediments to economic transactions or to promote economic and technical co-operation are encouraged to do so, while taking account of the interests of other economies as follows.*

WTO-consistency:

*All new arrangements should comply with any relevant principles or provisions of the WTO and associated agreements. Without prejudice to those, they should satisfy the following criteria:*

Transparency:

*(i) The policies adopted to implement these arrangements should be documented explicitly (typically expressed in legislation or regulations of those economies) and be freely available and accessible, through convenient channels of communication.*

*(ii) APEC economies should provide reasonable prior notice of the nature and objectives of proposed co-operative arrangements as well as the policies by which these are to be implemented.*

Non-discrimination: *The arrangements should not contain any provisions which result in new or additional discrimination, either against products on the basis of the location of production, or among producers on the basis of their place of registration or ownership.*

Accession:

*(i) Any economy whose government accepts the responsibilities as well as the benefits of following policies compatible with any existing or proposed co-operative arrangements among some APEC economies should be able to, and encouraged to, become parties to these arrangements.*

*(ii) Existing parties to these co-operative arrangements should be willing to share the information, experience, expertise and technology needed to enable others to adopt the relevant policies.*

Review: *APEC economies should endeavour to respond positively to constructive suggestions from other economies for improving the consistency of existing or proposed co-operative arrangements with APEC's agreed guiding principles for liberalising and facilitating trade and investment.*

Co-operative arrangements which meet these criteria could be conveniently, and deservedly, described as open clubs. There is reason to believe that APEC governments will adopt principles along these lines to guide the design of co-operative arrangements which are pioneered by some APEC participants, but are expected to be positive examples for subsequently wider application. Such principles for the design of open clubs can avoid the proliferation of arrangements which fragment, rather than integrate, regional markets.

Such principles or guidelines are also likely to prove useful in adapting co-operative arrangements which have been implemented in other regions in order to make them consistent with the Asia Pacific model of open regionalism. Most of the options for



facilitating or liberalising trade and investment which are under consideration in the Asia Pacific have already been implemented in other processes of regional economic co-operation. It would be unwise and inefficient for APEC economies to ignore this experience. On the other hand, such arrangements have not always been designed to be open clubs. Most existing co-operative arrangements among groups of economies contain provisions which discriminate explicitly among products and/or producers, thereby creating new market distortions. Moreover, few existing arrangements have well defined means of accession which can overcome short-term vested interests against wider participation and will need to be modified to fit APEC's style of co-operation.

Once adopted, such principles can also serve as a framework for the design of co-operative arrangements involving both APEC and non-APEC economies. For example, as noted at the outset, the recently initiated ASEM process is likely to lead to some practical co-operative arrangements to lower the costs and risks of trade and investment between European and East Asian economies. If such arrangements were consistent with the proposed principles, they would be quite consistent with the interests of other APEC participants who are not part of the ASEM process. Similarly, such principles would also help to ensure that the strengthening of economic links between other APEC participants and Europe also take account of all Asia Pacific economies. For example, such guidelines could be applied to any co-operative arrangements to reduce technical barriers to trade, possibly as part of the proposed New Transatlantic Marketplace; they could also serve as guidelines for future arrangements to reduce impediments to economic transactions between Russia and the EU.

## ***Conclusion***

Guiding principles of transparency, non-discrimination, accession and review, along the lines proposed in this paper, could have general relevance going beyond particular initiatives for regional economic co-operation, such as APEC, or the reform of selected sectors such as international air transport.

The international air transport system continues to lie outside the normal WTO-based rules for the international trading system. There is no likelihood that air transport can be brought under these rules in a single step - a new system is more likely to emerge through a sequence of bilateral and regional initiatives. If the principles that have been proposed in this paper were followed, then co-operative arrangements for more liberal air transport among pairs, or groups, of economies might be more likely to evolve smoothly towards a gradually more open and competitive system. If such a precedent proved useful in the case of international air transport, similar principles may also help to guide experiments in co-operation to address other new policy issues raised by the increasing complexity and sophistication of international economic transactions.

Such guidelines can also help to manage a '21-x' or 'variable geometry' approach to reducing impediments to trade and investment among APEC participants. They could also guide the evolution of new co-operative arrangements among some APEC economies and the rest of the world, particularly the EU. Guiding principles which met these challenges could also prove to be useful minimum criteria for new initiatives for closer economic co-operation among any group of economies. The principles proposed in this paper are not only consistent with the intent of both Article I and Article XXIV of the GATT/WTO as they apply to the progressive dismantling of border barriers to trade, but they can also serve to extend these concepts to the reduction of all impediments to all international economic transactions.

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